

# **DEFAULT SERVICE POLICIES TO BENEFIT RESIDENTIAL CONSUMERS**

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INITIATIVE



# For Further Information

Managing Default Service to Provide Consumer Benefits in Restructured States: Avoiding Short-Term Price Volatility (NCAT, June 2003), Available at:  
<http://neaap.ncat.org/experts/defservintro.htm>

Natural Gas Price Volatility: Regulatory Policies to Assure Affordable and Stable Gas Supply Prices for Residential Customers (ORNL Subcontract, 2004) Available at:  
<http://www.ncat.org/liheap/pubs/natgasvolbalex.doc>

An Analysis of Residential Energy Markets In Georgia, Massachusetts, Ohio, New York, and Texas (NCAT, September 2002). Available at:  
<http://www.ncat.org/neaap/experts/mainintro.htm>

Consumer Energy Council of America, “Restructuring the Electric Utility Industry: A Consumer Perspective” (April 2003), Available at:  
<http://www.cec.org/Programs/ElectricPower/RestForum/RestRep.htm>

# WHAT DID RESTRUCTURING PROMISE TO DELIVER?

- Lower Prices over the long term: more efficient way to obtain needed generation supply; reliance on market forces likely to result in environmental benefits because cleaner and newer generation would replace older and dirtier power plants.
- Customer Choice: new products and services; choice would reward marketers who delivered lowest cost or preferred product (e.g., “green”)

# WHAT HAS HAPPENED?

- RESULTS ARE COMPLEX AND VARY AMONG THE STATES
- LOWER COST GENERATION? The “bet” on natural gas has backfired; surplus capacity; generators overpaid for old plants, resulting in bankruptcy, consolidation
- ENVIRONMENTAL BENEFITS? Some new large scale renewables due to renewables portfolio requirements and more customer options for “green” power
- RESIDENTIAL CUSTOMER CHOICE: NOT!
- RETAIL PRICES LOWER? “Savings” due to rate caps and not competition per se; future risk of volatile prices significantly higher

# SHOPPING AND CUSTOMER CHOICE

- IN GENERAL, LESS THAN 5% OF RESIDENTIAL CUSTOMERS HAVE CHOSEN A COMPETITIVE SUPPLIER. IN MOST STATES, LESS THAN 1%
- HIGH SHOPPING RATES IN PA HAVE ERODED
- EXCEPTION: MUNICIPAL AGGREGATION IN OH, BUT SOME OF THE SAVINGS DUE TO ARTIFICIAL “SHOPPING CREDIT”
- TEXAS: 10-12% RESIDENTIAL CUSTOMER MIGRATION, BUT UNIQUE MARKET MODEL UNLIKELY TO BE DUPLICATED
- HIGHER SHOPPING RATES FOR LARGER CUSTOMERS IN MOST JURISDICTIONS

# PRICE VOLATILITY

- IN STATES THAT ADOPTED RATE CAPS OR RATE FREEZES FOR A TRANSITION PERIOD, LITTLE ADVERSE IMPACT FROM RESTRUCTURING EXPERIMENT, EVEN WHEN NO SHOPPING (EXAMPLES: PA, MD, CT, MI, VA, IL, DL, OH)
- ADVERSE IMPACTS WHEN SHORT TERM WHOLESALE MARKET RATES ARE PASSED THROUGH TO RESIDENTIAL CUSTOMERS (EXAMPLES: ConEd IN NY; MA; CA; TX PRICE TO BEAT FUEL ADJUSTMENTS)
- WHAT HAPPENS WHEN THE RATE CAPS OR FREEZES EXPIRE?

# CURRENT STATUS OF RESTRUCTURING

- NO STATE HAS ADOPTED RESTRUCTURING SINCE 2000
- STATES THAT CAN POSTPONE OR REPEAL HAVE DONE SO: AZ, NV, NM, CA, AR, OK, WV
- THE END OF THE PRICE CAP WORLD IN NJ, MD, CT, DC
- IL AND PA FACE CHANGES OVER NEXT SEVERAL YEARS
- ALL EYES ON FERC AND WHOLESALE MARKET
- NO FEDERAL MANDATE IS LIKELY

# CHOICES

- KEEP TRYING TO MAKE RETAIL COMPETITION WORK
  - PENNSYLVANIA, NEW JERSEY, MASSACHUSETTS, MAINE
- TRY TO RECREATE COST OF SERVICE PRICE REGULATION
  - CALIFORNIA, ARIZONA, NEVADA
- CREATE ALTERNATIVE CHOICE MODEL
  - OREGON



# FOCUS ON DEFAULT SERVICE IN EVERY MODEL

- ALMOST ALL RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS ARE BEING SERVED BY DEFAULT PROVIDER
- NO PROSPECT OF MASS MIGRATION TO COMPETITIVE SUPPLIERS [MANY HAVE ABANDONED THIS MARKET]
- STATES MUST DECIDE WHO AND UNDER WHAT CONDITIONS ELECTRICITY WILL BE PROVIDED TO ALMOST ALL RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS

# DEFAULT SERVICE POLICIES ARE KEY TO DEVELOPMENT OF HEALTHY WHOLESALE MARKET

- DEFAULT SERVICE PRICES AND PRICE VOLATILITY WILL BE DEFINED BY STATE POLICYMAKERS
- DEFAULT SERVICE PRODUCTS ORDERED BY STATE COMMISSIONS FOR RETAIL CUSTOMERS WILL DRIVE THE DEVELOPMENT OF PRODUCTS IN WHOLESALE MARKET
- WHOLESALE MARKET IS STRUGGLING WITH HOW TO DEVELOP LONG TERM CAPACITY MARKET
- KEY TO SUCCESS OF WHOLESALE MARKET IS LONG TERM CONTRACTS: DOE ENERGY BOARD AND FERC CHAIRMAN PAT WOOD

# RECENT DECISIONS

- MONTANA, CALIFORNIA, AND ARIZONA ARE ADOPTING PROACTIVE POLICIES FOR LONG TERM MANAGEMENT OF DEFAULT SERVICE
  - MONTANA: DEFAULT ELECTRICITY SUPPLY PROCUREMENT GUIDELINES AND HB 509; STATUTORY POLICY IS TO REQUIRE DISTRIBUTION UTILITIES TO PROVIDE DEFAULT SUPPLY SERVICE AT “LOWEST LONG-TERM TOTAL COST”; 10-15 YR PROCUREMENT PLAN UNDER REVIEW AT PSC THAT INCLUDES DSM AND RENEWABLES
  - SEE PROPOSED PLAN AT [WWW.MONTANAENERGYFORUM.COM](http://WWW.MONTANAENERGYFORUM.COM)

# RECENT DECISIONS

- MOST NORTHEAST AND MID ATLANTIC STATES ARE MAKING SHORT TERM DECISIONS THAT EMPHASIZE THE PASS THROUGH OF COMPETITIVE WHOLESALE MARKET BIDS THAT ARE VERY SHORT TERM (1-3 years)
  - NJ: AUCTIONS WITH PRICES THAT REFLECT A BLEND OF 1, 2, AND 3 YEAR CONTRACTS
  - MD: 50% OF ALL CUSTOMERS IN ONE YEAR BID; 50% FOR 2-3 YEAR BIDS
  - MA: DEFAULT SERVICE PRICE BIDS FROM 6 MOS. TO 12 MOS.

# MAINE DEFAULT SERVICE MODEL

- UNDER MAINE LAW, THE MAINE PUC MUST ISSUE THE RULES AND CONDUCT THE BIDDING FOR STANDARD OFFER SERVICE; THEN ORDERS UTILITY TO SIGN WINNING CONTRACT
- 3 YR FIXED PRICE CONTRACT SIGNED IN 2002 FOR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS
- LINK TO UTILITY-OWNED QF ENTITLEMENTS TO 'BUY DOWN' SOS PRICE
- WINNING BIDDER IS IDENTIFIED ON UTILITY-ISSUED CUSTOMER BILL WITH NAME AND PRICE OF GENERATION SUPPLY PROVIDER, BUT NO RETAIL RELATIONSHIP
- PROCEEDING UNDERWAY TO CONSIDER WHETHER FUTURE ACQUISITIONS SHOULD BE SEGMENTED AND MULTI-TERM TO AVOID RISKS OF PRICE VOLATILITY

# RECENT DISTRICT OF COLUMBIA DECISION

- PSC HAS MANDATED A WHOLESALE DEFAULT SERVICE MODEL
- FOR RESIDENTIAL CUSTOMERS, UTILITY MUST CONSTRUCT A PORTFOLIO OF MULTI-YEAR FIXED PRICE CONTRACTS OF 1-3 YRS OR MORE WITH AT LEAST 40% OF 3 YEARS “OR MORE” DURATION
- COMPETITIVE BIDDING VIA COMMISSION APPROVED RFP PROCESS

# RECENT CT LEGISLATION

- CONNECTICUT LEGISLATION (SB-733) EXTENDS STANDARD OFFER SERVICE PERIOD FOR 3 YEARS
- BEG. IN 2007, LOCAL DISTRIBUTION UTILITIES ARE REQUIRED TO ASSEMBLE A PORTFOLIO OF CONTRACTS TO PROVIDE LONG TERM DEFAULT SERVICE FOR RESIDENTIAL CUSTOMERS
- FIRST STATE IN NORTHEAST TO RECOGNIZE THAT DEFAULT SERVICE PORTFOLIO MUST BE MANAGED

# WHAT IS WRONG WITH SHORT TERM BIDS FOR DEFAULT SERVICE SUPPLY?

- VERY RISKY BUSINESS TO BID 100% OF LOAD IN ONE POINT IN TIME FOR SHORT PERIOD
- RISKY TO RELY ENTIRELY ON SHORT TERM CONTRACTS EVEN IF STAGGERED TIME PERIODS
- WHOLESALE MARKET IMMATURITY
- FAILS TO SUPPORT ENVIRONMENTALLY SUSTAINABLE RESOURCE ACQUISITION (DSM AND RENEWABLES)
- DOES NOT SUPPORT LONG TERM INVESTMENT IN GENERATION SUPPLY (FINANCIAL COMMUNITY)
- POTENTIAL PRICE VOLATILITY; POLITICAL AND CONSUMER BACKLASH; REAL HARM TO WORKING CLASS AND LOW INCOME CUSTOMERS; MOST RESIDENTIAL CONSUMERS CAN'T RESPOND TO "REAL TIME" PRICES WITHOUT HARDSHIP



# COMPARE RECENT BIDS IN NEW JERSEY AND MARYLAND

- New Jersey conducted wholesale auction in February 2004 for 1-yr and 3 yr fixed price contracts: auction price average of 5.46 cents per kwh for 1-yr and 5.52 cents per kwh for 3-yr
- Maryland conducted RFP in March 2004 for 1-3 year contracts: average 26% increase in generation supply portion of the bill for R customers of PEPCO (31% for electric heat customers) or 16-19% increase in total annual bill (\$164 increase in annual bill on average; \$213 for electric heat customers)
- Between December 2003 and March 2004, PJM on peak forward prices increased 17%!

# THE TEXAS MODEL

- UNIQUE; NO OTHER STATE HAS MANDATED STRUCTURAL SEPARATION
- SUPPLIERS BILL AND COLLECT ELECTRIC BILL
- PRICES QUOTED IN CENTS PER KWH FOR ENTIRE BILL
- AFFILIATE TO INCUMBENT UTILITY CREATED TO PROVIDE PRICE TO BEAT (DEFAULT SERVICE) FOR MULTI-YEAR PERIOD AND GIVEN ALL CUSTOMERS
- PRICE TO BEAT PRICE CHANGES; 32-37% INCREASES IN TOTAL BILL SINCE JAN. 2002
- 10-12% MIGRATION BY RES. CUSTOMERS

# WHO SHOULD MANAGE DEFAULT SERVICE?

- COMMISSION OR LEGISLATURE MUST ADOPT OVER ARCHING POLICIES
- COMMISSION MUST SUPERVISE COMPETITIVE ACQUISITION AND APPROVE PLAN AND RESULTING PORTFOLIO; SUPERVISE AFFILIATE CONTRACTS; MONITOR WHOLESALE MARKET
- FOCUS ON INCUMBENT DISTRIBUTION UTILITY [ONLY MAINE HAS ATTEMPTED OTHERWISE]
  - PLANNING AND ACQUISITION; MANAGEMENT OF PORTFOLIO
  - BILLING AND COLLECTION FOR RETAIL CUSTOMERS

# SHOULD DEFAULT SERVICE BE DESIGNED TO KICK START RETAIL COMPETITION?

- SOME MARKETERS PROPOSE “RETAIL” MODEL IN WHICH CUSTOMERS ARE BID OUT OR TRANSFERRED TO A COMPETITIVE SUPPLIER
- THIS APPROACH TYPICALLY ASSOCIATED WITH MORE VOLATILE AND SHORT TERM PRICES
- PA BID EXPERIENCE UNSUCCESSFUL
- SUPPLIERS HAVE NOT OFFERED CONSOLIDATED BILLING ON A LARGE SCALE TO RESIDENTIAL CUSTOMERS [PA; NJ]

# SHOULD BILLS BE UNBUNDLED?

- ILLINOIS IS ONLY RETAIL COMPETITION STATE WITH BUNDLED RETAIL BILLS
- LACK OF UNBUNDLED BILLS PREVENTS INDIVIDUAL CUSTOMER SHOPPING
- DEFAULT SERVICE COMPATIBLE WITH BUNDLED ELECTRIC BILL OR UNBUNDLED BILLS, BUT KEY IS COMMISSION REVIEW AND APPROVAL OF GENERATION SUPPLY PRICES

# DEFAULT SERVICE PRICES AND PRICE CHANGES

- A VARIETY OF APPROACHES ARE LIKELY TO BE DEVELOPED, BUT ERA OF “LET’S MAKE A DEAL” IS LIKELY OVER
- MULTI-YEAR PERFORMANCE BASED RATES SHOULD BE EXPLORED; AUTOMATIC FUEL COST ADJUSTMENTS DO NOT PROVIDE PROPER INCENTIVE TO MANAGE PORTFOLIO TO REDUCE PRICE VOLATILITY
- ANNUAL PRICE CHANGES BASED ON RESULTS OF AUCTION PORTFOLIO IN NJ, MD
- RESIST MORE FREQUENT PRICE CHANGES BASED ON WHOLESALE MARKET INDEX

# WHAT ARE KEY ATTRIBUTES OF PROACTIVE MANAGEMENT OF DEFAULT SERVICE?

- PROCUREMENT PLAN
- EMPHASIS ON VARIETY OF CONTRACT LENGTHS; CONTRACT TYPES AND RISK PROFILES
- COMPATIBLE WITH COMPETITIVE BIDDING IN WHOLESALE MARKET AND COMPETITIVE RFPs FOR BILATERAL CONTRACTS
- REDUCE RISKS WITH PRE-APPROVAL OF PLAN AND REASONABLE RESTRICTIONS OR FEES IF CUSTOMERS SWITCH (SEE, E.G., 25% SWITCH TRIGGER IN RECENT MD STIPULATION)
- STATE POLICY RE RENEWABLES AND ENERGY EFFICIENCY REFLECTED IN PORTFOLIO

# WHY PROACTIVE MANAGEMENT OF DEFAULT SERVICE WILL BENEFIT CONSUMERS AND COMPETITION

- LOWER LONG TERM SYSTEM COSTS
- LESS VOLATILE AND MORE STABLE RATES
- PROMOTE EFFECTIVE WHOLESALE MARKET COMPETITION (SEE, E.G., DOE'S ELECTRICITY ADVISORY BOARD REPORT [SEPT. 2002] THAT CONCLUDED THAT INVESTMENT COMMUNITY DISFAVORED RELIANCE ON SHORT TERM AND SPOT MARKET)
- INCREASE RELIABILITY WITH DIVERSE AND BALANCED PORTFOLIO
- LOWER ENVIRONMENTAL IMPACTS
- COMPATIBLE WITH CUSTOMER CHOICE



# CONCLUSION

- THE EMPEROR HAS NO CLOTHES!
- THERE IS NO EVIDENCE THAT RETAIL COMPETITIVE SUPPLIERS WILL PROVIDE ESSENTIAL ELECTRIC SERVICE TO RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS
- DEFAULT SERVICE MUST BE MANAGED TO PROVIDE AFFORDABLE AND STABLE RATES
- THE LACK OF PROACTIVE PLANNING AND MANAGEMENT WILL HARM CONSUMERS AND PREVENT THE DEVELOPMENT OF AN EFFECTIVE WHOLESALE MARKET